# Office of Chief Counsel
# Internal Revenue Service
# Memorandum

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subject: Cellulosic Biofuel Claims

This memorandum responds to your request for assistance dated August 25, 2010. This advice may not be used or cited as precedent.

ISSUE

Whether an election under § 40(f) of the Internal Revenue Code (the Code) operates as an election out of § 40 of the Code for all purposes in a taxable year?

CONCLUSION

An election under § 40(f) of the Code does not operate as an election out of § 40 for all purposes in a taxable year.

FACTS

Black liquor, a byproduct of the paper milling process, is an alternative fuel under § 6426(d)(2)(G) of the Code. When combined with at least 0.1 percent (by volume) of diesel fuel, black liquor is eligible for the § 6426(e) alternative fuel mixture credit. Black liquor is also eligible for the § 40(b)(6) cellulosic biofuel producer credit. However, a registered producer of cellulosic biofuel is not allowed a credit under both § 6426(e) and § 40 for the same volume of black liquor, for reasons discussed below.

The § 6426(e) alternative fuel mixture credit expired December 31, 2009. The § 40(b)(6) cellulosic biofuel credit is effective for qualified cellulosic biofuel produced after December 31, 2008. The Health Care and Education Reconciliation Act of 2010 (Pub.L. 111-152), however, amended the definition of cellulosic biofuel, effective for fuels sold or used after December 31, 2009, to exclude black liquor. Thus, both the § 40 and § 6426 credits apply to black liquor sold or used only during calendar year 2009.

The IRS developed procedures to allow black liquor producers to repay the § 6426(e) credit and claim the § 40 credit for the same volume of black liquor. The § 6426(e) credit is $0.50 per gallon and the § 40(b)(6) credit is $1.01 per gallon of cellulosic biofuel that is not alcohol.

Black liquor producers are either calendar year or fiscal year taxpayers. Black liquor producers began combining black liquor with at least 0.1 percent (by volume) of diesel fuel (that is, producing an alternative fuel mixture) on widely varying dates during calendar year 2009, and thus could not claim the § 6426(e) credit for any period before they produced and used the alternative fuel mixture. The black liquor, however, was eligible for the § 40(b)(6) cellulosic biofuel producer credit at all times during calendar year 2009. Some black liquor producers now want to claim the § 40 credit for the months during which they could not claim the § 6426(e) credit. Others want to repay only part of the § 6426(e) credit and claim the § 40 credit in a way that maximizes their tax benefit. Therefore, you have asked us whether the black liquor producer may claim the § 40(b)(6) credit for one volume of black liquor and the § 6426(e) for a different volume of black liquor during the same taxable year.

LAW AND ANALYSIS

There are three "coordination of benefits" provisions between §§ 40 and 6426, which are found in §§ 40(c), 6426(g), and 6426(h). Section 40(c) provides that the amount of the credit determined under § 40 with respect to any alcohol must be reduced to take into account any benefit provided with respect to such alcohol by reason of the application of § 6426 or 6427(e) (allowing the § 6426 credit to be taken as a payment instead of a credit against excise tax). Section 6426(g) provides that rules similar to the rules under § 40(c) apply to claims under § 6426. Therefore, these provisions contemplate that a taxpayer may claim a credit under both §§ 40 and 6426 for the same volume of alcohol in the same taxable year, but only if the taxpayer reduces the § 40 credit to take into account the amount of the § 6426 credit.

Black liquor is an alternative fuel as defined in § 6426(d)(2); it is not an alcohol. Therefore, instead of applying the "coordination of benefits" provisions of § 40(c) and 6426(g), relating to alcohol, we apply § 6426(h), which provides that no credit shall be determined under § 6426(e) for any fuel with respect to which a credit may be determined under § 40. In other words, if a credit may be determined under § 40 for any particular gallons of fuel, § 6426(h) does not allow a taxpayer to claim any credit whatsoever under § 6426 for those gallons of fuel. Thus, whereas §§ 40(c) and 6426(g) act to offset each other, § 6426(h) forces the taxpayer to make a claim under § 40, except as discussed below.

For black liquor, a cellulosic biofuel credit may be determined under § 40. Therefore, absent any other authority, § 6426(h) would require a black liquor producer to claim a credit under § 6426 for all gallons of black liquor. Section 40(f), however, allows the producer to elect out of the § 40 credits for any taxable year. Section 301.9100-6T(e) of the Treasury Regulations further provides that the § 40(f) election is made by simply not claiming the § 40 credit. Thus, a claim under § 6426(e) operates as a § 40(f) election out of the cellulosic biofuel producer credit. Therefore, the producer may claim a credit under § 6426 instead of § 40. Section 6426(h), however, precludes any allocation between §§ 6426(e) and 40(b)(6) for the same gallon of fuel (for example, claiming $0.50 per gallon under § 6426(e) plus $0.51 per gallon (the difference between $1.01 and $0.50) under § 40(b)(6) for the same gallon of black liquor).

The question now presented is whether this “deemed” § 40(f) election precludes any claim whatsoever under § 40 for the taxable year, even for different gallons of fuel. Section 40(f)(1) provides that a “taxpayer may elect to have [§ 40] not apply for any taxable year.” A possible reading of this provision is that the taxpayer must choose either § 40 or § 6426 for the entire taxable year. If that were the answer, however, then §§ 40(c) and 6426(g) (which contemplate that a credit may be allowable under both §§ 40 and 6426 for the same gallon of alcohol fuel) would be meaningless. Therefore, the § 40(f) election cannot operate to preclude all other claims under § 40 for the taxable year. Thus, it is reasonable to conclude that an election under § 40(f) does not preclude all other claims under § 40 for the taxable year.

In addition, taxpayers have a number of factors to consider when deciding whether to claim a credit under § 40. Section 40, for example, is a nonrefundable general business income tax credit under § 38(c). In addition, the ordering rules of § 38(d) require the general business income tax credits to be applied in the order in which they are listed in § 38(b) (because the § 40 alcohol fuels credit is found in § 38(b)(3), it is third in a list of over 30 possible credits). Also, § 87 requires the amount of the § 40 credit to be included in gross income. In addition, a taxpayer may obtain a greater tax benefit by electing out of the ordering rules of § 38(d) and the income inclusion rules of § 87. An election under § 40(f), therefore, allows a taxpayer to take into consideration all available tax benefits. Therefore, we conclude that the § 40(f) election is designed to assist taxpayers in this determination, rather than provide any sort of coordination of benefits with § 6426.

Further, a conclusion that an election under § 40(f) of the Code does operate as an election out of § 40 for all purposes in a taxable year would result in unintended consequences. For example, the § 40(b)(2) alcohol fuel credit (for uses or retail sales of alcohol that is not in a mixture (straight alcohol)) does not have a parallel provision in § 6426; rather, this credit can only be claimed under § 40 on Form 6478, Alcohol and

Cellulosic Biofuel Fuels Credit. Alcohol fuel mixture credits, however, are allowed by both §§ 40(b)(1) and 6426(b). A taxpayer that produces both straight alcohol and alcohol fuel mixtures would be eligible for both credits. Taxpayers ordinarily prefer the § 6426(b) credit for alcohol mixtures because it can be claimed not only on an annual basis on the Form 6478 (or Form 4136, Credit for Federal Tax Paid on Fuels), but also on a quarterly basis as a credit against excise tax (on Form 720, Quarterly Federal Excise Tax Return) or as a cash payment under § 6427 (on Schedule 3 (Form 8849) Certain Fuel Mixtures and the Alternative Fuel Credit) as often as once a week. If one reads § 40(f) literally, however, then any otherwise allowable claim under § 40(b)(2) for straight alcohol would be disallowed simply because the taxpayer chose to claim the alcohol fuel mixture credit under § 6426(b) instead of under § 40(b)(1), even though there is no other mechanism for making a claim related to the straight alcohol, and even though the credits would be for different volumes of fuel.

Finally, the regulations in § 301.9100-6T(e) provide that simply not making a claim under § 40 acts as an election under § 40(f). Thus, if a taxpayer fails, by mistake or otherwise, to make any allowable claim under any part of §40, a literal reading of § 40(f) would preclude all claims under § 40. We think such a result is contrary to the purpose behind § 40(f).

Sections 40(c) and 6426(g) contemplate allowing credits under §§ 40 and 6426 not only for the same taxable year, but also for the same volume of alcohol (as long as the § 40 credit is properly reduced to take into account the amount of the § 6426 credit). In contrast, § 6426(h) precludes a claim under both provisions for the same volume of black liquor. Further, a literal application of § 40(f) would have unintended consequences. Therefore, we conclude that an election under § 40(f) of the Code does not operate as an election out of § 40 for all purposes in a taxable year. In addition, a black liquor producer may claim a credit under § 6426(e) (for black liquor used as a fuel in an alternative fuel mixture) and a credit under § 40(b)(6) (for cellulosic biofuel) in the same taxable year for different volumes of black liquor.

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Please contact Michael Beker at (202) 622-3130 if you have any further questions.